TREASURY CONSULTATION ON THE NATIONAL HOUSING FINANCE AND INVESTMENT CORPORATION

The National Housing Finance and Investment Corporation

A single entity containing an infrastructure facility and a bond aggregator

CHIA supports the concept of a single National Housing Finance and Investment Corporation which supports both the Bond Aggregator and the National Housing Infrastructure Facility. We consider that the corporation could be well-placed to house other national functions to advance affordable housing, including regulation of affordable housing and independent forecasting of housing supply and demand. In the short-term, we encourage the Government to fold the National Rental Affordability Scheme (NRAS) into the NHFIC and use the corporation as a vehicle for delivering any future capital funding or loan programs designed to expand affordable housing. We have not examined the benefits of delivering funding under the National Housing and Homelessness Agreement to the states through this vehicle, but acknowledge that there may be benefits in such a move.

Board independence, investment mandate and Government direction

We endorse the intention that the NHFIC have an independent Board which is guided by an investment mandate framed by Government, the accountability and performance requirements of the *Public Governance, Performance and Accountability Act, 2013* and which operates within clear objectives and guidelines set out in its enabling legislation. We suggest that the objectives and guidelines expressed in the NHFIC's enabling legislation are not too prescriptive, to enable its Board the room to develop detailed policy and procedures in consultation with the broader market. Within the bounds of its legislated objectives the corporation should have some capacity to evolve over time, as would a commercial corporation.

In relation to the suggestion in the Budget papers that the Government could be able to direct the NHFIC to invest in particular projects or locations, we appreciate the reasons why Government may wish to do this. However, we suggest that this could create tension with the requirements for the independent Board in meeting its accountabilities and draw your attention to the Commonwealth Auditor-General's 2011 report on the Housing Affordability Fund.[1] In that instance, the objects of the Fund were circumvented to enable funding to be directed to renew public housing estates. Part of the reason was to compensate the state government for the withdrawal of other funding which had been promised under the Social Housing Initiative but later withdrawn by the Commonwealth due to budgetary pressures. While the Fund was a grant program, not a corporation, the diversion of funds reduced the overall impact of the Fund in making housing more affordable. Similar problems could be expected to arise if the Government were able to direct the NHFIC how to deploy its infrastructure funds. In relation to the Bond Aggregator, we cannot conceive of any grounds on which it would be defensible for the Government to direct funds to an individual organisation or in respect of a particular project; an application to borrow will either meet the prudent lending requirements, scheduling and priorities of the NHFIC, or it will not. The responsibility of the NHFIC Board is to ensure that those standards are met.

[1] Australian National Audit Office. Implementation and Management of the Housing Affordability Fund, 2011.

We suggest that the enabling legislation for the NHFIC be cast in a way which does not preclude the possibility of it taking on additional functions such as those mentioned above. Further, in light of the relative lack of knowledge of the community housing sector across the investor community, we suggest that there would be merit in appointing a community housing sector representative to the Board. An alternative would be for the NHFIC Board to appoint separate advisory committees on the NHIF and the Bond Aggregator.

National Housing Infrastructure Facility

The amount of funds currently earmarked for the NHIF are relatively modest and there is unlikely to be any difficulty in identifying good candidate projects. We expect that an early task of the NHFIC Board would be to endorse a simple set of criteria consistent with its mandate which details things like alignment to strategy, risk profile, community need, return on investment and so on, together with a clear gateway assessment process through which a project business case must pass before approval. Ideally the NHFIC Board would have the benefit of robust forecasts of housing need and supply, along the lines of that previously provided by the National Housing Supply Council to inform its investment decisions. In the absence of such independent forecasting, it is suggested the NHFIC ask the state and territory governments for five and ten-year forecasts of housing need. Additionally, there would be value in the NHFIC seeking advice from industry on planning reform proposals which could be funded to deliver more widespread benefits than would be possible from a series of individual infrastructure projects.

CHIA suggests that 'infrastructure' should be interpreted to include both physical infrastructure and the policy systems which support that infrastructure, such as precinct planning, land management systems, development approval processes and so on. Reform in these areas are likely to have longer-lasting impact on housing affordability. Community infrastructure such as playgrounds, wetlands or sportsgrounds should be in scope as well as 'hard infrastructure such as road and utilities.

Funding to address infrastructure bottlenecks

A central criteria for assessing infrastructure investments should be how much the investment will speed delivery; this should be part of the gateway assessment Lengthy development approval processes indicate inefficient planning processes, and cause economic loss through the delay of growth-enhancing investment. Tracking the average decision time gives insight into whether a city is effectively managing its regulatory processes. Reducing the time between lodgement of a development application and turning the key in the door of the first home will reduce holding costs for developers, but it is admittedly tricky to capture these savings to ensure they are passed on to purchasers. Projects which have the support of all stakeholders, particularly state and local governments, should be given more weighting than other projects because agreement will obviously improve the prospects of success.

Given the relatively small scale of the NHIF, we recommend against 'pass-through' funding to developers which simply reduces costs to homebuyers by $10,000 to $20,000 without leveraging any additional benefit (as resulted under the Housing Affordability Fund). Support of projects which cross local government boundaries, such as wider precinct planning, would be of benefit over the medium term even if they do not deliver significant early wins.

What the NHIF should take into account in assessing projects

The four most important things which the NHIF should take into account in assessing projects are the extent to which the proposal increases overall housing supply, the extent to which it brings forward developments (as measured by months, rather than weeks), the extent to which it speeds up development processes generally, and the extent to which it increases social and affordable housing supply. In this context, we suggest that affordable housing is defined to include rental at 20% or more below comparable market rent and affordable home ownership is defined to be affordable for a household in the third quintile of income. Proximity to public transport and accessibility to employment are two other important metrics which we suggest be used to assess projects. Additional factors include community expectations, the built form, energy efficiency, risk factors around development, build, funding, pricing and markets, the target buyer profile for the final product and the balance between affordable home purchase and affordable rental supply

The challenge of remoteness

Much of the discussion on housing affordability centres on the high cost of land and construction in Sydney. However, remoteness imposes additional costs in terms of transport, constrained labour supply and in the north of Australia the building code imposes additional requirements for cyclone proofing. Climatic extremes impose additional wear and tear costs on both infrastructure and housing, such as the need to protect roads against wash away from cyclonic rainfall in far north Queensland or the Northern Territory. Additionally, the small scale and distributed populations of most regional and remote councils makes it difficult to defray infrastructure costs across a broader ratepayer base. The result is that the loading of infrastructure costs on to purchasers of new properties is even more pronounced than it is in capital cities. We recommend that special consideration be given to infrastructure projects in regional and remote parts of Australia, notwithstanding that these will usually be of smaller scale.

Other financing approaches

Another financing approach which would be considered is incentive/reward payments to state and territory governments to reform planning systems. For example, the adoption of mandatory inclusionary zoning where developers can opt-in to meet a target of 15% social and affordable housing in exchange for concessions on stamp duty or infrastructure charges in respect of the affordable housing component of a development. The NHIF could also be used to provide incentive payments for projects which involve value capture, however we recommend that the incentive payments be conditional on the uplift in rateable values, betterment taxes or similar being quarantined to support additional housing supply (preferably affordable housing supply) rather than being absorbed without trace into the general revenue of state or local government authorities.

BOND AGGREGATOR

Lending should not be restricted to Tier 1 and 2 organisations (or equivalent)

Lending from the Bond Aggregator should be restricted to registered community housing organisations because the regulatory framework for CHOs provides assurance about governance and financial performance which will reduce the due diligence investigation effort by the Bond Aggregator. Conversely, requiring registration would underline the importance of the role of the national regulatory scheme. It is noted that for-profit organisations can register as community housing providers in all states except Victoria. Rather than proposing a special exemption to accommodate for-profit organisations which wish to operate in Victoria, it would be preferable for Victoria to join the national regulatory scheme.

There is no policy reason to preclude for-profit providers of affordable housing from borrowing from the Bond Aggregator, providing they are registered community housing providers and the purpose of the borrowing is to deliver affordable housing. Meeting these two conditions is a reasonable expectation in return for access to cheaper finance on better terms which has been facilitated by the taxpayer.

Equally, there is no basis to exclude Tier 3 (or equivalent) organisations solely on the basis of the tier to which they are currently assigned. A number of Tier 3s run in remote areas and finding funding is critical. Others may presently operate a small community housing function within a much larger organisation (for example, aged care, disability services, or faith-based organisations) and have land or other equity which could make a valuable contribution to affordable housing supply. Unlocking the ability to finance small developments for example, 4 – 10 units is a worthwhile investment if it becomes the start of something much bigger. Of course once these organisations undertake development activities, their tier status will be re-rated.

In the first instance some of these Tier 3 organisations may seek to borrow at very modest levels which would increase the overhead for the Bond Aggregator in assessing borrowing applications for small amounts. Accordingly we propose that a dedicated bond issuance be reserved for Tier 3 organisations in the second or third year of the Bond Aggregator's operations. This would give time for the borrowers to thoroughly prepare (including preparing business cases for their internal stakeholders to make land or equity available) and could be more easily managed by the Bond Aggregator via a boost to its temporary workforce to assess many smaller loan applications.

Loans for maintenance and turn-key purchases and construction finance

Loan funding should not be tied to specific purposes and not restricted to turn-key acquisitions. The core requirement must be that the loan is secured and can be paid back from ongoing cash-flow. Using a loan for operational purposes or maintenance does not signal a CHO's incapacity to operate effectively, but rather an intention to free up income for other activities including property development or purchase. Precluding CHOs from using borrowings to undertake development and requiring them to apply funds to turnkey acquisitions instead would stymie the hoped-for increase in affordable housing supply which is the purpose of establishing a Bond Aggregator. This is because a CHO with charitable status which undertakes development will fold the value of both its tax exemptions and its developer margin back into additional supply. In this way, the CHO can deliver 25% more dwellings than a developer which sells completed properties to a CHO. The CHO sector and developers have quite close relationships which will enable developments to be delivered at scale. (It is also worth remembering that following the GFC, CHO purchases of completed properties from developers were critical in preventing some developers from going under)

Form of security which CHOs should be asked to provide

Two forms of security which the NHFIC Board could consider to support CHO borrowings are security against property title or against the CHO's ongoing cash- flow of rental income. During the first few years, as the Bond Aggregator seeks to build the market for affordable housing bonds, potential investors are likely to be more reassured if the NHFIC adopts the more familiar approach of requiring security against bricks and mortar. However, it must be recognised that this approach would significantly limit the amount which CHOs can borrow. At present, community housing organisations hold title to a little over a third of the $30.8 billion portfolio of assets under their control, with the rest held under short or long-term management contracts from state and territory governments.[2]

Circumstances in which the loans should be unsecured

There are some circumstances in which it may make sense not to require security for loans, for example, small borrowings relative to the scale of the borrower's holdings, borrowings for short periods for discrete projects, or where there is a 'cocktail' of funding which makes a venture less risky. Removing the security requirement would streamline processes and reduce compliance overheads for both the Bond Aggregator and the borrower. However, in its initial phase while the bond aggregator is settling in, it is suggested that security be required for all borrowings. This could be reviewed after three years once more data on loan performance and administration costs was available.

Forms of financial covenants which should exist alongside the security

The principle which should guide the imposition of any additional financial covenants is to set the minimum requirement which reflects the borrower's ability to repay both principal and interest from EBITDA within the context of an 18 month cash flow forecast. The approach of the Bond Aggregator should that of banks, which undertake due diligence up-front and then do not intervene as long as repayments continue to be made and standard notification requirements are met (for instance, changes of directors). Strengthening the operation of the National Regulatory Scheme for Community Housing also provides additional cover for the lender.

If the CHO has multiple lenders, where should the Bond Aggregator security rank

Most governments, including the Commonwealth, use standard tripartite agreements to protect the taxpayers' interests in assets which involve multiple funders, lenders or users. Where the Bond Aggregator is lending to a community housing organisation which proposes to use a property in which there is no government interest but on which a mortgage already exists, it is presumed that the Bond Aggregator security would rank behind the existing lender.

The costs and benefits of contracting out the Bond Aggregator back office functions?

Banks have well-established capability to undertake some of the functions associated with the NHFIC, including warehousing finance and maintenance of a liquidity facility and we would recommend testing the market before deciding to establish parallel capabilities within government.

How would a Government guarantee affect the NHFICs ability to raise and price bonds? What are the risks of a guarantee and how could this be mitigated?

The EY report proposes that a Government guarantee would reduce the cost of borrowing and increase the likely take-up of affordable housing bonds. We consider that a Government guarantee will be required in the initial years of the Bond Aggregator, however the need for a Government guarantee should reduce over time as the market acquires more information about the performance of the community housing sector and is thus able to properly assess the risk as extremely low. We note that in the Australian context it is extremely rare for a community housing organisation to fold, and in these rare instances the state government step-in arrangements ensure that the tenants,

[2] The proportion of stock owned by CHOs is particularly low in Tasmania (3%) and Queensland (12%) reflecting the evolution of the sector in those states and the conservative approach of state governments to transferring social housing stock to community housing organisations with title.

assets, and liabilities are transferred to another housing operator. Similarly, in the UK there have not been any defaults recorded by the Housing Finance Corporation over 30 years of lending.

The key to mitigating the risks to the Australian Government of providing a guarantee is to have an effective system of regulation in place. However, under the current devolved regulatory arrangements, the Australian government has no control over the standard of regulatory oversight conducted by the states and territories. Formal agreements with the states on how and when step-in powers would be exercised by state regulators in the event of default would help, but will not be sufficient, since the real objective of regulation is to prevent default in the first place. The optimal protection would be a national regulator which operates under Commonwealth law. This would assure the Bond Aggregator and its investors of the effectiveness of the regulatory oversight and minimise risk to the Australian Government in guaranteeing the borrowing.

A further issue is that the Australian sector's risk profile is framed by Government policy settings at state and Federal level. State government constraints on the use or sale of assets are not just an issue for investors in the event of wind up of a company, but prevent CHOs from maximising the use of the assets under their management. These constraints include tenant allocation and rent-setting policies, restrictions on the use to which the property can be put, or contract requirements that limit the capacity of a CHO to accumulate reserves to fund expansion. The consequence is compressed margins and increased financial vulnerability of providers. To mitigate the risks to CHO viability imposed by state contract management practices, we recommend that the new National Housing and Homelessness Agreement include a commitment to develop a contract management framework which better balances protection of taxpayer-funded assets with the objective of expanding the supply of social and affordable housing.

Beyond regulation, there is a range of mechanisms which could be employed to reduce the need for a guarantee over time. For example, establishing a debt reserve facility of 12 months interest on the bond could be achieved over time by imposing a small surcharge on borrowers to gradually accumulate a small float. Other strategies to create a small liquidity buffer include requiring payments a month before coupon payments are due, calling in loans six weeks before the nominated settlement date to ensure the principal is repaid to the investor on time, or requiring borrowers to post a one-month advance payment amount at the time they take out the loan to cover any late payment. There are other ways to spread risk and reduce the need for a guarantee which the NHFIC Board could consider – for example, by preventing a single CHO from taking more than 30% of any single issuance.

In the initial phase of the Bond Aggregator we would hope that the cost of providing a guarantee is carried by the Government, until investors have time to properly assess risk of investment in this sector and reflecting the relatively small scale of borrowings (perhaps $1.4 billion over 5 years). However once bond issuances are repeated at sufficient scale to become part of the bond index, we would hope that the price of borrowing will drop and community housing borrowers will then be in a position to fund the guarantee. From a broader perspective, of course, the cost to government of providing a guarantee is offset by the benefits to the community of facilitating additional affordable housing supply.

OTHER ISSUES – MEETING THE FUNDING GAP

The NHFIC consultation paper acknowledges the NHIF and the Bond Aggregator will not be sufficient to resolve housing affordability – while these are both valuable measures, they can only be part of the solution to a complex issue. At the heart of the matter is the unavoidable fact that subsidized housing for people on low to moderate incomes requires a subsidy from Government and for those on very low incomes in high-cost housing markets, this subsidy will be substantial. The gap between market and social rents is raised on page 8 of the EY report on the bond aggregator. It is critical that the National Housing and Homelessness Agreement delivers on some of the strategies to fill the funding gap which are outlined in the final report of the Affordable Housing Working Group, including reform of planning systems and the contribution of government land, free or at a substantial discount to valuation, to facilitate the supply of affordable housing. these measures, together with accelerated transfer of social housing stock to community housing organisations, with title, will provide a solid platform for the success of the Bond aggregator.